Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Runner	Analyst:	Gloria McConnell	Bill Number:	AB 485
Related Bills:	See Legislative History	Telephone:	845-4336	Introduced Date:	02/21/01
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Joint Strike Fighter Program Credit/Extends Repeal Date

SUMMARY

This bill would extend for two years the tax credits related to the Joint Strike Fighter (JSF) program.

PURPOSE OF THE BILL

According to the author's office, the JSF tax credits were created to increase CA's competitiveness to obtain the engineering and manufacturing development (EMD) phase of the JSF program. This phase has been delayed for approximately two years. Accordingly, this bill extends the tax benefits for the extended EMD phase of the JSF project.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. However, it would be operative for tax years beginning on or after January 1, 2001, and before January 1, 2008.

POSITION

Pending.

Summary of Suggested Amendments

As discussed under "Technical Considerations," technical amendments are needed to correct the reference to the specified taxable years and limit the credit to the EMD phase of the JSF program. Suggested amendments are attached for the author's convenience.

ANALYSIS

FEDERAL/STATE LAW

Under current state law, qualified taxpayers are allowed a wage credit and a property credit for the JSF program. Qualified taxpayers are defined to include those taxpayers under an initial contract or subcontract to manufacture property (further described under Background) for ultimate use in a JSF. The credits are available for taxable years beginning on or after January 1, 2001, and before January 1, 2006. Any excess credit can be carried forward for up to eight years.

Board Position:			Department Director	Date
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The credits are allowed only if the bid upon which the JSF contract or subcontract is based is reduced by the credit amount. The taxpayer is required to provide, at the request of the Franchise Tax Board, all references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a JSF contract or subcontract.

- The *wage credit* is generally equal to a specified percentage (50% for 2001, 40% for 2002, 30% for 2003, 20% for 2004, and 10% for 2005) of employee wages that are direct costs allocable to property manufactured in this state for ultimate use in a JSF, with certain limitations.

- The *property credit* is generally equal to 10% of the cost of qualified property used by a taxpayer primarily in qualified activities to manufacture a product for ultimate use in a JSF, with certain exceptions. The property credit is to be recaptured if, within one year of being placed in service, the property is sold, moved out of state, or used for purposes other than manufacturing a product for ultimate use in a JSF.

There are no comparable federal credits specifically for the JSF program.

THIS BILL

This bill would:

- extend the period of time for which the wage and property credits are available. The credits would be available until taxable years beginning before January 1, 2008, instead of 2006.

- change the taxable years for which the specific percentages would apply to employee wages. (50% for 2001 to 2004, 40% for 2002 to 2005, 30% for 2003 to 2006, 20% for 2004 to 2007, and 10% for 2005 to 2008)

This bill would be effective upon enactment and would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2008.

IMPLEMENTATION CONSIDERATION

This bill should not significantly affect the department's operations or programs.

TECHNICAL CONSIDERATIONS

This bill in reality, but not technically, limits the manufacturing activities to those in the EMD phase of the JSF program, as further discussed under "Background." The attached Amendment 5 would make the technical limitation.

This bill creates an unintentional overlap in the taxable years for which the specific percentages would apply to employee wages (50% for 2001 to 2004, 40% for 2002 to 2005, 30% for 2003 to 2006, 20% for 2004 to 2007, and 10% for 2005 to 2008). Under this provision of the bill, the credit amount for taxable year 2003 would be calculated at 50%, 40%, and 30% of wages.

The credit for taxable year 2004 would be calculated at 40%, 30%, and 20% of wages. According to the author's office, applying multiple percentages to wages paid in any given year was not the author's intent. The author's office does not anticipate the EMD phase wages to begin until mid to late 2002, and wants the "50% wage credit" to apply for at least the first full taxable year. The attached Amendments 1 through 4 would eliminate the unintentional overlap and apply the 50% wage credit to taxable years beginning 2002 and 2003; the 40% wage credit to taxable years beginning 2004; and so forth.

The current property credit makes a technical incorrect reference to another part of the provision. The attached Amendment 6 makes the correction.

LEGISLATIVE HISTORY

AB 390 (1997/98; Runner) introduced the JSF tax credits. This bill died on the Assembly floor in February 1998.

AB 1779 (1997/98; Runner) re-introduced the JSF credits. This bill died in the Assembly Committee on Appropriations.

AB 2797 (Stats. 1998, Chapter 322; Machado) was amended to include the JSF credits. The bill was enacted as the Budget Trailer/Conformity Act of 1998.

PROGRAM BACKGROUND

The JSF Program is the Department of Defense's focal point for defining "affordable next generation strike aircraft weapon systems" for the Navy, Air Force, Marines, United Kingdom Royal Navy, and other U.S. allies. There are five phases to the JSF program: exploration, development, demonstration, EMD, and production.

The **exploration and the development phases** have long been completed.

The **demonstration phase** is in its final stages of completion with The Boeing Company and Lockheed Martin Corporation being awarded the contracts for this phase. This phase features flying concept demonstrators, concept-unique ground and flight demonstrations, and continued refinement of the contractors' preferred weapon system concepts. It was scheduled for commencement in fiscal year 1997 and completion in fiscal year 2000. However, as recently as February of this year, flight testing and demonstrations were being done.

The **EMD phase** is basically the manufacturing of complete prototype aircraft or related products (property) that will be used when making the final approval for the aircraft in the JSF program. As a result of the demonstration phase, the initial contract for the EMD phase is expected to be awarded either to The Boeing Company or to Lockheed Martin Corporation later this year. According to the author's office, the EMD phase is estimated to take six years to complete, beginning in 2002 or later.

The **production phase** is planned thereafter. The initial contract and subcontract work for the production phase is expected to be performed outside California.

OTHER STATES' INFORMATION

Missouri and *Texas* are two other states that may be affected by the award of the EMD phase of the JSF program. According to the author's office, Boeing's EMD work may take place in Missouri and Lockheed Martin's in Texas. Tax incentives specifically for the JSF program could not be identified in either state.

FISCAL IMPACT

This bill is not expected to impact the department's costs significantly.

ECONOMIC IMPACT

Tax Revenue Estimate

Revenue losses for this bill are projected to be as follows:

Fiscal Year Cash Flow Impact Enactment Assumed After 6/30/01 $ Millions			
2001-2	**2002-3**	**2003-4**	**Total 2002-2009**
0	**(1)**	**(3)**	**(100)**

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Revenue Discussion

This bill modifies the wage and the property credits linked to the Joint Strike Fighter (JSF) program, as follows:

Wage credit --This bill modifies the wage credit in two ways:

- extends the credit's expiration date, and
- increases the percentage of wages that qualify for the credit from: 40% to 50% in 2002; from 30% to 50% in 2003; from 20% to 40% in 2004; from 10% to 30% in 2005; from 0 to 20% in 2006; and from 0 to 10% in 2007.

In all years, however, the amount of qualifying wages remains capped at $10,000 per employee.

Based on discussions with the Department of Trade and Commerce (DTC), the average wage in the aircraft production industry is $60,000. If the EMD phase of the JSF program is brought to California, the prime contractor would create at least 1,000 JSF-related California jobs. Assuming that qualified subcontractors produce an additional 3,000 qualified jobs, the total amount of wages eligible for the credit would be about $40 million annually (4000 jobs x $10,000 per employee cap).

The actual revenue loss from this bill is determined by the interaction of the wage percentages (eligible wages) and the $10,000 cap. For example, for an employee earning $50,000 in 2002, the bill increases eligible wages from 40% to 50%, or from $20,000 to $25,000 for this employee. Since both of these wage amounts exceed the $10,000 cap, there is no revenue change for this employee in this year. In 2005, by contrast, eligible wages would increase from 10% to 30%, or from $5,000 to $15,000 for this employee. However, because of the cap, the employer may still only claim $10,000. Hence, the resulting revenue loss from this bill for this employee in 2005 is $5,000 ($10,000 under the bill - $5,000 under current law).

The revenue loss over the life of the bill is projected to be approximately $100 million, but most of that loss comes in the last three years of the program.

Property credit --This estimate assumes that contracts for the EMD phase of the JSF will be awarded late in 2001, and contracts for the production phase of the JSF program will not be awarded until after these credits expire.

This bill would basically extend the property credit from 2005 to 2007. Except for this extension of the property credit, this bill makes no other change to this credit. Therefore, there would be no direct revenue effect from this credit for those years before the extension. This analysis assumes that major capital purchases related to the EMD phase of the JSF program will be made early in the phase before beginning construction of prototype aircraft. Therefore, the revenue impact of the extension of the property credit is projected to be small relative to the revenue impact of the wage credit.

LEGAL IMPACT

Staff is in the process of drafting proposed regulations for these JSF tax credits. This bill should not significantly affect that regulation process. Any changes to current law resulting from this bill would be incorporated into the regulation process.

ADDITIONAL COMMENT

As discussed under current law, excess JSF credits can be carried forward for up to eight years. No credit would be allowed unless the bid upon which the JSF contract or subcontract is based is reduced by the credit amount.

Statistically, at least eight years is needed for a taxpayer to exhaust a credit, thereby receiving maximum benefit from the credit. However, unlike other credits, a taxpayer claiming the JSF credit must first reduce its contract bid by the amount of the credit it expects to claim under the contract. Eight years may not be sufficient time to fully utilize the credit and allow the taxpayer to recover the required bid reduction. Therefore, taxpayers may be hesitant to claim the credit and the author may want to consider making an exception for this credit by extending the carryover period beyond the eight years or making it unlimited.

An unlimited carryover period would allow a taxpayer the maximum time period to recoup its mandatory bid reduction and would also be consistent with the unlimited carryover period in the enterprise zone credits (Sections 17053.74(i) and 23622.8(f)), which may also apply to a JSF program taxpayer.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 485
As Introduced February 21, 2001

AMENDMENT 1

On page 2, line 11, and page 10, line 36, strike out "2002" and insert:

2004

AMENDMENT 2

On page 2 line 14, and page 10, line 39, strike out "2003" and insert:

2005

AMENMDENT 3

On page 2, line 17, and page 11, line 2, strike out "2004" and insert:

2006

AMENDMENT 4

On page 2, line 20, and page 11, line 3, strike out "2005" and insert:

2007

AMENDMENT 5

On page 2, line 24, page 5, line 24, page 11, line 9, and page 14, line 3, after "property" insert:

for the engineering and manufacturing development phase

AMENDMENT 6

On page 4, line 27, and page 13, line 6, after "in" insert:

subparagraph (B) of